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**ANALYSIS ON THE STATE OF THE NATION ADDRESS (SONA) 2022: IMPLICATIONS FOR SMALL BUSINESS DEVELOPMENT**

**(Small Business Development)**

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# INTRODUCTION

The 2022 State of the Nation Address occurred on the backdrop of increased economic activity due to the easing of the COVID 19 restriction to level 1 lockdown. This is as close as the country has been to pre COVID 19 normal. The unemployment situation however has become worse with the country reaching the highest unemployment levels since 2008. Subsequently, in the current year, the focus among others is on, unblocking and reducing regulatory burdens to help grow and create jobs in the formal and informal sector.

# WHAT IS SONA 2022 SAYING ABOUT SMALL ENTERPRISES?

## 2.1 SMMES AND JOB CREATION

The President announced that in 2022, government is undertaking far-reaching measures to unleash the potential of small businesses, micro businesses and informal businesses. These are the businesses that create the most jobs and provide the most opportunities for poor people to earn a living. We have started discussions with social partners as part of the social compact process to review labour market regulations for smaller businesses to enable them to hire more people, while continuing to protect workers’ rights.

The recent statistics show that the official unemployment rate in the country was 34.9 per cent in the third quarter of 2021 – the highest since 2008. While youth unemployment was at 66 per cent. The unemployment rate according to the expanded definition of unemployment was 46,6% in the third quarter 2021[[1]](#footnote-1). This is much higher than some of the other emerging markets. China’s unemployment rate stood at 5.1 per cent in 2021, while India’s was at 8 per cent and Brazil’s at 11.6 per cent.[[2]](#footnote-2)

The country’s 2030National Development Plan, places the responsibility of creating 90 per cent of new jobs in South Africa on the SMME sector. The International Labour Organisation (ILO) notes that in the majority of developing and emerging countries, the small and medium size businesses provide more employment than large enterprises.[[3]](#footnote-3) The same is true in South Africa, see Table below. Between 2017 and 2021 the SMME contribution to employment ranged from 54.3 per cent at its lowest to 66.5 per cent at its highest. While the informal business sector is the largest in the economy constituting about 66 per cent of all businesses in the country.

Number of jobs created by SMMEs and overall employment (2017-2021)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Period | Q1 2017 | Q1 2018 | Q1 2019 | Q1 2020 | Q1 2021 |
| Formal | 725 698 | 658 719 | 736 198 | 755 265 | 667 111 |
| Informal | 1 658 522 | 1 714 233 | 1 754 443 | 1 748 031 | 1 552 814 |
| Total | 2 478 877 | 2 443 163 | 2 550 540 | 2 614 063 | 2 325 203 |
| No of jobs | 10 568 701 | 8 886 015 | 10 839 819 | 10 406 070 | 9 757 287 |
| Overall employment | 16 212 000 | 16 378 000 | 16 291 000 | 16 383 000 | 14 995 000 |
| SMME jobs as % of Overall employment | 65.2% | 54.3% | 66.5% | 63.5% | 65.1% |

Source: SEDA and Statistics South Africa (2017-2021)

In its Decent Work Agenda, the ILO states that employment and decent work are important because they deliver a fair income and are key elements to among others; poverty reduction, sustainable livelihoods, social protection for families, personal Development, preventing situations of crisis resulting from conflict and disasters and promoting peace.[[4]](#footnote-4) In his address, the President highlighted the role played by the small, micro and informal businesses in sustaining livelihoods, alleviating poverty and the high level of unemployment.

The ILO notes however, that work in the informal economy has its cons. It is often characterized by small or undefined work places, unsafe and unhealthy working conditions, low levels of skills and productivity, low or irregular incomes, long working hours and lack of access to information, markets, finance, training and technology. Workers in the informal economy are not recognized, registered, regulated or protected under labour legislation and social protection.**[[5]](#footnote-5)**

### 2.1.1 Challenges faced informal sector in South Africa

To unleash its potential government will have to address several constraints, such as, among others, securing proper working space, dealing with excessive competition amongst fellow traders as well as, a lack access to financial services as some do not have access to a basic bank account and or proof of address.[[6]](#footnote-6) Most banks including development finance institutions avoid serving small and informal businesses because they are seen as risky. For instance, sefa report that the cost of supporting micro-enterprises is very high as the transactional costs per loan far exceeds the returns where cost recovery is greatly compromised.[[7]](#footnote-7)

The number of micro-finance institutions (MFIs) which provides short term, unsecured loans to survivalist entrepreneurs and informal small businesses has decreased over the years. The International Finance Corporation (IFC) notes that membership in the Development Microfinance Association decreased from 37 to seven members. While in its 2021 annual report, **sefa** noted that in the past decade, only two large MFIs have continued to survive and smaller MFIs no longer exist. Thus access to credit and finance for the small and informal businesses is very limited[[8]](#footnote-8).

The country’s regulatory framework can also be a hindrance to growth, for instance;

* The National Credit Act No. 34 of 2005 requirement for three months’ bank statements limits the ability of start-ups to get funding.
* The South African Local Government Association (SALGA) and the Socio-economic Rights Institute (SERI) of South Africa, state that “there are a number of flaws in current policy and by-laws, as they are intended to protect municipalities rather than empower traders.”[[9]](#footnote-9) SLAGA and SERI state that this is evident in cases where informal traders who are poor, often powerless and trading to earn a meagre living are unlawfully removed from their trading areas.[[10]](#footnote-10)

Furthermore, for formal SMMEs, a Small Enterprise Development Agent (SEDA) report notes that South Africa’s labour laws, although well-intentioned to benefit workers they are a significant regulatory burden to SMMEs. For instance, having to register employees with the Department of Labour’s Compensation Fund in order to comply with the Compensation for Occupational Injuries and Disease Act No. 130 of 1993 takes roughly 30 days finalise. By comparison, a similar procedure takes one day in Chile.[[11]](#footnote-11) In addition SMMEs noted that labour laws do not provide for cyclical downswings in small businesses. SMMEs also complain that it is difficult to lay the workers off, if the business can no longer afford to keep them or if they prove to be unproductive.[[12]](#footnote-12) In his 2022 address, the President announced plans to increases the value and expand the criteria for participation in the Employment Tax Incentive to make it easier for small businesses to hire employees. The SONA 2022 notes that Minister of Finance will to announce the details of these changes in the budget.[[13]](#footnote-13)

The ILO states that to promote decent work in the informal sector, there needs to be a comprehensive and integrated strategy that eliminates the negative aspects of informality, while preserving the significant job creation and income generation potential of the informal economy.

## 2.2 CREATING AN ENABLING ENVIRONMENT

The State of the Nation Address, stated that the key task of government is to create the conditions that will enable the private sector – both big and small – to emerge, to grow, to access new markets, to create new products, and to hire more employees.

### 2.2.1 Access new markets

Access to markets are important for SMMEs and cooperatives “as no enterprise can survive without access to markets.[[14]](#footnote-14)” Author Christian M. Rogerson notes that “the more existing small enterprises are provided with an opportunity to access markets, the more the revenue they will generate, and more jobs will be created due to business growth and expansion.”[[15]](#footnote-15) Inadequate access to market opportunities is identified as one of the major causes of business failure and the high rate of churning of the SMME economy.[[16]](#footnote-16)

1. ***Market Concentration***

The South African economy is essentially still dominated by large monopolies (retail and wholesale, energy supply, telecommunications, financial services and the transport sector being prime examples). According to the Competition Commission Report, the top 10% of businesses earn 86% of total income while the bottom 50%, the smaller businesses, earn 1.6% of the income.

Compared to new entrants, incumbents in any market have significant advantages due to among others marketing, brand loyalty, particularly the existing scale of their operations and having been present in the market for a longer period of time. In addition, large dominant firms have the ability to engage in a number of exclusionary acts aimed at keeping competitors out of the market.[[17]](#footnote-17)

List of dominant players in the retail industry

|  |  |  |  |
| --- | --- | --- | --- |
| Retail segment | Incumbents | (market share) 2015 | (market share) 2018 |
| Supermarkets | Shoprite, Spar, PnP, Woolworths (CR4) | 57.1% | 58.3% |
| Apparel | Edcon, Woolworths, Foschini, Truworths, Woolworths (missing Pepkor) | 64.2% | 57.9% |
| Building/Home improvement | Massbuild, Spar’s Build It, Cashbuild, Pepkor’s The Building Company | 48.8% | 50.7% |
| Pharmacy | Clicks and Dischem | 38.3% | 49.0% |
| Online | Takealot, BidorBuy, Superbalist, Onedayonly |  | 77.3% (Oct 2020 |

Source: Competition Commission (2021)

The Competition Commission’s recent Retail Market Inquiry found that not only did exclusive leases keep out small grocers but also those leases required developers to ensure 75-80 per cent of space leased to national chains. This increases the cost of doing business for small companies and reduced access to new markets and government procurement opportunities.[[18]](#footnote-18) The Competition Commission concluded that, “the South African economic conditions and structure are hostile to SMMEs and therefore undermine inclusion and the job creation potential of the economy.”

The African Continental Free Trade Area agreement presents opportunities to access new markets across the continent. The World Bank notes that the agreement gives African countries access to market of 1.3 billion people across 55 countries with a combined gross domestic market of product (GDP) valued at US$3.4 trillion.[[19]](#footnote-19)

“To unlock the untapped potential, various intra-African non-tariff barriers, including costly non-tariff measures, infrastructure gaps and market information gaps, need to be successfully addressed.”[[20]](#footnote-20)

Other structural barriers that prevent small enterprises from accessing new markets include, among others, the following;

1. ***Infrastructure***

* *Spatial mismatch*: Due to South Africa’s Apartheid history, there are large geographical distances between areas of production, particularly for Africans, and the country’s economic hubs.
* *Transportation:* It relatively costly to travel to the economic hubs for business purposes, and these are the areas where their businesses are most likely to grow and mature.
* *Land:* Many *b*usinessesneed access to productive and suitable land as well as affordable premises that are close enough to workers, the market, safe and suitable for work. SMMEs face difficulties in accessing land or securing operating premises in the agriculture, manufacturing, ICT and tourism sectors. They add that land access has often been hampered by many companies’ inability to secure leases from municipalities. Consequently, SMMEs particularly businesses located in townships and informal settlements, resort to operating out of illegal or informal premises. resents health and safety risk for workers.[[21]](#footnote-21)

According to a National Treasury paper, there are three ways to support SMMEs to address high levels of concentration in the economy as well as distorted ownership patterns:

(i) leverage the role of public procurement;

(ii) reduce red tape; and

(iii) broaden financing options.[[22]](#footnote-22)

In the 2021/22 financial year, the Department allocated R307.2 million to the Market Access Programme which is responsible for facilitating and increasing access to markets for SMMEs through business information, product development support and value chain integration.[[23]](#footnote-23)

1. ***Crime and corruption***

* *Crime:* According to the Development Policy Research Unit, crime is a major constraint, particularly for informal enterprises. It also creates barriers to the access of inputs and products as suppliers prefer not to operate in high-crime areas.
* *Corruption:* The DPRU survey, some SMMEs reported that they were expected to give gifts to secure government contracts to obtain an import licence, to get an electrical and water connection[[24]](#footnote-24). The DPRU notes that smaller firms are disadvantaged by these corruption costs as larger firms are more likely to be able to absorb these costs.[[25]](#footnote-25)

## 2.3 Access to finance: From Loan Guarantee Scheme to Bounce-back Scheme

A new, redesigned loan guarantee scheme is being introduced to enable small businesses to bounce back from the pandemic and civic unrest. In the 2022 SONA it is stated that the new bounce-back scheme incorporates lessons from the previous loan guarantee scheme. It will involve development finance institutions and non-bank SME providers in offering finance, expand the types of financing available and adjust eligibility criteria to encourage greater uptake. The National Treasury is working with industry stakeholders to finalise the scheme and will provide details soon.

The Loan Guarantee Scheme (LGS) did not perform as expected. The National Treasury initially provided R200 billion to the banking industry through the South African Reserve Bank. Of that amount approximately, R18,39 billion representing only 9.2 per cent in loans had been approved by banks and taken up by small businesses.[[26]](#footnote-26)

The LSG received 50 717 applications, of which 13 324 representing 26 per cent were approved by banks and were taken-up by the applicants.[[27]](#footnote-27) Approximately 56 per cent of applications received were rejected by June 2021, because;

* They did not meet the eligibility criteria for the scheme, as set out by the Treasury and the Reserve Bank, or because they did not meet banks’ risk criteria.
* The requested value of the loan was too high for the business to be reasonably expected to be able repay it;
* The enterprise was not in good financial standing before the pandemic.

Government never envisaged the Loan Guarantee Scheme to provide grants and qualifying recipients must be able to repay the loan.[[28]](#footnote-28)The banks were not allowed to make profit from the scheme and the 3.5% margin**. [[29]](#footnote-29)**

Here below is an example of the eligibility criteria and requested documents required to apply for the LSG;

**Eligibility Criteria**

* An eligible business is defined as:
* Any company, statutory body corporate, close corporation, sole proprietorship, trust or partnership, association, joint venture or any similar entity, but excludes state-owned entities, listed companies and companies with capital market funders or funding instruments
* Having an existing relationship of either lending or transactional banking with Investec
* Being in good standing as at 31 December 2019
* Being registered with SARS
* Having no existing capacity to borrow
* Being adversely impacted by the lockdown and requiring funding for qualifying expenses during lockdown or to restart operations under the different levels of lockdown
* An entity that has declared that it has not applied for this relief at any other bank

**Submission of documents**

* A calculation of the facility required by the business to fund up to six months of qualifying expenses
* A detailed cash flow projection should support this and substantiate the requested facility
* Year-to-date management accounts noting the current financial position and financial performance
* Most recent financial statements
* Proof of SARS registration
* Constitutional documents of the applicant (if not already in bank's possession)
* Where the entity has already applied for this loan at another bank, proof that the application was declined, including reasons (if any)
* If required, additional supporting evidence to substantiate specific qualifying operational expenses (eg, rates bills, rental agreements, etc).[[30]](#footnote-30)
* The Banking Association South Africa (BASA) noted the need for the reduction of red-tape and policy uncertainty, and for it to be made easier to do business, especially for small and medium enterprises, so as to increase uptake and benefit businesses in distress.

# REGULATORY ENVIRONMENT (BEE) / RED TAPE

The President stated that Government, through the Department of Small Business Development, is reviewing the Business Act – alongside a broader review of legislation that affects SMMEs – to reduce the regulatory burden on formal and informal businesses. The President announced that he appointed Mr Sipho Nkosi to lead a team that will focus on cutting red tape and focus on other, including mechanisms to ensure government departments pay suppliers within the required 30 days, simplify processes relating to property registration, cross-border trade and construction permits.

## 3.1 Regulatory burden

Regulation of activities of the SME sector is an important function of government in any country. The conditions under which business activities take place must be governed by sound policies, laws and regulations to ensure that all men and women in South Africa can obtain decent and productive work, in conditions of freedom, equity, security and human dignity.[[31]](#footnote-31) It is relatively quick and affordable to register a business on-line with the national business registration authority, the Companies and Intellectual Property Commission (CIPC). A company registration may vary between R125 and R475 (R125 for a private company, R475 for a non-profit company registered without members)[[32]](#footnote-32).

Nevertheless, it remains difficult for many small businesses to comply with subsequent laws and regulations. These include, costly environmental protection, employee welfare and tax regulations, the costs of compliance with obtaining black economic empowerment (BEE) certification, applying for a tax incentive, or accessing a learnership through a sector education and training authority (SETA), compliance with labour laws, tax and tax-related issues, municipal regulations, licenses or sector-specific permit systems administered by local governments among others.

Tax practitioners, Anthea Scholtz and Claudia Gravenorst note that the cost of tax compliance remains a significant challenge, because SMMEs often lack the resources and skills needed to comply fully and timeously with all their tax obligations. “The cost of tax compliance can add significantly to the cost of doing business for SMMEs (e.g. additional resources that have to be employed to comply with tax rules, significant penalties imposed for non-compliance with tax rules etc.)”[[33]](#footnote-33).

Here below are some of the taxes that SMMEs have to pay the following taxes;

SARS Small Business Essential Tax Guide

|  |  |
| --- | --- |
| Tax type | Submission  frequency |
| Company Income Tax  (CIT) | Once a year as per company’s financial year end |
| Personal Income Tax (for self-employed  individuals) | Once a year as announced by  SARS during filing season |
| VAT | Every two (2) months before  the 25th |
| PAYE | Monthly on or before the 7th |
| Provisional Tax | Twice a year |
| Turnover Tax | Once a year |
| Employer reconciliation | End of October and end of May |

SARS (2021)

## 3.2 Pay suppliers within 30 days

The Department of Monitoring and Evaluation reports that delayed and/or non-payments not only affect a company’s growth but also those who are directly and indirectly associated with the company. These individuals range from employees and their families, the business owners, their families and the wider society as there are trickledown effects.[[34]](#footnote-34)

National Treasury reports that**, out of 40** national departments only eight (8) or 20%, including the Department of Small Business Development, managed to achieve a 100% compliance rate on submission of 30 days’ during the 2020/2021 financial year[[35]](#footnote-35). Unpaid provincial invoices amounted to R26.6 billion in 2020/21 while at national level they amounted to R4.1 billion over the same period.[[36]](#footnote-36)

According to the information presented to the National Treasury, the following departments paid all their invoices within 30 days during the 2020/2021 financial year as required by Treasury Regulation

• National School of Government;

• Planning Monitoring and Evaluation;

• Public Service and Administration;

• Traditional Affairs;

• Communications and Digital Technologies;

• Small Business Development;

• Sports, Arts and Culture; and

• Trade, Industry and Competition[[37]](#footnote-37).

The Department of Monitoring and Evaluation notes that “SMMEs are less likely to complain while larger more established companies have the resources to hold Government to account and levy interest on all late payments.”[[38]](#footnote-38)

Big businesses are also not paying SMMEs on time. According to an online publication, Small business site, since COVID 19 “late payments are at an all-time high as small businesses are waiting too long to get paid.[[39]](#footnote-39) The average amount owed to each small business is now at its highest level. In addition, when the problem persists too long, it can ultimately shut down a small business.’

According to the City Press online, one company had adopted a 120 day policy to pay small business suppliers.[[40]](#footnote-40) Recently South African businesses have signed a public agreement to pay small and medium enterprise (SME) suppliers within 30 days. The initiative, called “Pay In 30”, is led by Business for South Africa (B4SA), the SA SME Fund, and Business Leadership South Africa (BLSA), and supported by, amongst others, Business Unity South Africa (BUSA), the Small Business Institute (SBI) and the Black Business Council (BBC).[[41]](#footnote-41)

# SONA 2021: INDIRECT RELATION TO SMALL ENTERPRISE SECTOR

1. *Cannabis Market:* Government is reviewing the policy and regulatory framework for industrial hemp and cannabis to realise the huge potential for investment and job creation. The legalisation of cannabis could be the much-needed job creating disruption that will help boost the economy. It is dubbed South Africa’s green gold. However, the minimum cost of R3 million cost of obtaining a licence for the cultivation of medicinal cannabis tends to excludes small-scale farmers who were able to make a small profit in the underground market.
2. ***Small scale farmers:*** Through the Sugar Master Plan, the industry has provided R225 million to over 12,000 small-scale sugar cane growers as part of a R1 billion commitment to support black farmers. Government will be expanding the provision of input vouchers and calling on other sectors to join this effort, in order reach up to 250,000 small-scale farmers this year.
3. ***Electricity Load reduction/ power outages*** continue to have a huge impact on the lives of all South Africans, disrupting business activities, and placing additional strains on families and communities.

# IMPLICATIONS FOR THE PORTFOLIO COMMITTEE ON SMALL BUSINESS DEVELOPMENT

The Portfolio Committee on Small Business Development could;

1. Listen to the Minister of Finance’s budget speech, for pronouncements on criteria for expanding participation in the Employment Tax Incentive that will make it easier for small businesses to employ young people. Furthermore, request the Departments of Small Business Development, Treasury and Labour to brief the Committee on the implementation plan and implications as well as expected outcomes of expanding the criteria for participation in the Employee Tax Incentive for SMMEs.
2. When the red tape reduction has been established, consider requesting the Presidency together with Mr Sipho Nkosi to brief the Committee on the mandate and terms of reference of the team.
3. Request the Department of Small Business Development and Trade Industry and Competition African to present on the Continental Free Trade Area agreement and new market opportunities for SMMEs and cooperatives.
4. Request the Competition Commission to brief the Committee on their initiatives in relation to the levelling playing fields and opening up markets to new entrants, cooperatives and SMMEs owned by the historically disadvantaged can participate.
5. Invite Business for South Africa (B4SA) to brief the Committee on SMEs that are owed money outside of payment terms by large companies, the “Pay In 30” days campaign and how it is monitored.
6. Ask National Treasury and **sefa** to brief the Committee on the bounce-back scheme and how to expand uptake for struggling SMMEs.
7. Invite the Department of Small Business Development to elaborate on the review of the Business Act and the reduction of the regulatory burden on the informal sector.

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